# CURRENTS

WESTERN CANADA'S ECONOMIC BULLETIN

Canada West FOUNDATION

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→ ENERGY EXPORTS → MARKET DIVERSIFICATION → INTERPROVINCIAL TENSIONS

## Monthly Highlights

### Modest Growth in 2011

After two months of flat or negative growth, the Canadian economy finished 2011 on a relatively strong note, with a 0.4% increase in December. For the year as a whole, real gross domestic product (GDP) grew by 2.5%, down from a 3.2% growth rate a year earlier.

Goods production was the main driver of economic growth in 2011. In particular, GDP in durable goods manufacturing was up 5.0% in 2011, a good follow-up to its even stronger 8.0% growth rate in 2010. Construction and energy sector activity also helped spur the Canadian economy forward in 2011.

An especially welcome bit of news in 2011 was strong growth in business investment. In particular, investment in machinery and equipment rose by 13.7% last year, finally offsetting a sharp decline two years earlier. This investment, partially attributable to a strong Canadian dollar making it relatively cheap to import machinery and equipment, is good news for the long-term success of the Canadian economy as it signals important productivity gains down the road.

Meanwhile, labour markets continue to struggle. Echoing the national trend, employment growth in western Canada was flat through January and February as job gains in BC and Saskatchewan were offset by losses in Alberta and Manitoba. BC has been the bright spot so far in 2012, creating more jobs since November than any other province, while also converting a significant number of part-time jobs to full-time positions.

| Monthly Economic Statistics | BC | AB | SK | MB | Canada | Reference Month |
|---|---|---|---|---|---|---|
| **Labour Markets** | | | | | | |
| Employment (000s) | 2,301 | 2,128 | 529 | 625 | 17,354 | February |
| *% change from previous month* | 0.4 | -0.3 | -0.1 | -0.2 | 0.0 | |
| Unemployment rate (%) | 6.9 | 5.0 | 5.0 | 5.6 | 7.4 | February |
| *change in percentage points from previous month* | 0.0 | 0.1 | 0.0 | 0.2 | -0.2 | |
| Participation rate (%) | 65.1 | 73.7 | 69.1 | 69.0 | 66.5 | February |
| Average weekly earnings ($) | 855.00 | 1,064.80 | 893.21 | 814.38 | 888.26 | December |
| *% change from previous month* | 0.4 | 1.6 | -0.5 | 0.3 | 0.7 | |
| **Inflation** | | | | | | |
| Consumer Price Index (% change from Jan. 2011) | 1.7 | 2.9 | 2.3 | 2.0 | 2.5 | January |
| **Economic Activity** | | | | | | |
| Retail trade ($M) | 5,028 | 5,573 | 1,394 | 1,415 | 38,614 | December |
| *% change from previous month* | -1.4 | -0.7 | -3.5 | 0.8 | -0.2 | |
| Wholesale trade ($M) | 4,320 | 6,374 | 1,832 | 1,360 | 49,552 | December |
| *% change from previous month* | -0.5 | -0.3 | -3.3 | 3.7 | 0.9 | |
| Manufacturing sales ($M) | 3,104 | 6,322 | 1,136 | 1,304 | 49,944 | December |
| *% change from previous month* | -1.9 | -3.5 | 0.8 | 1.0 | 0.6 | |

*Unless otherwise noted, data are seasonally adjusted.*
*Source: Statistics Canada*


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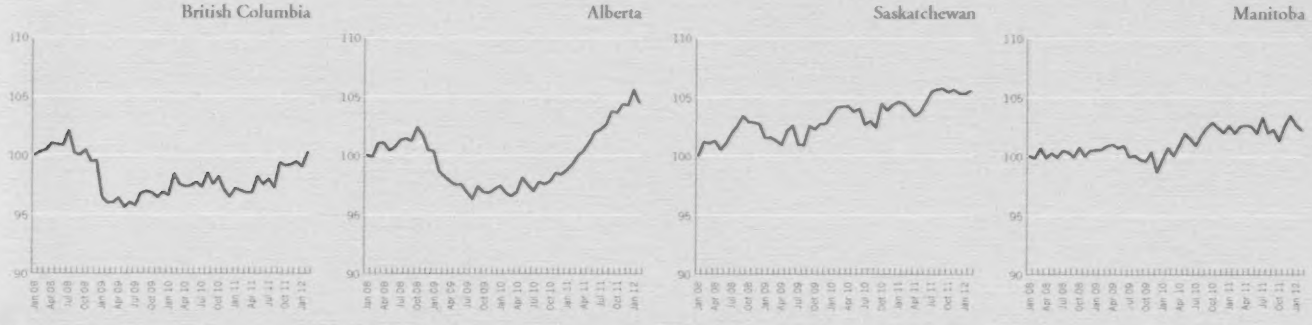
FULL-TIME EMPLOYMENT (INDEX: JAN. 2008=100)

*Source: Canada West Foundation calculations using Statistics Canada data*



## Monthly Feature

# Energy Drives Western Canadian Export Growth in 2011

While rhetoric is flying over the effect that western Canada's soaring energy exports are having on the exchange rate and, consequently, the competitiveness of central Canada's manufacturing sector, there is fresh evidence of the extent to which sales of energy products to the United States are driving export growth in the West.

Year-end figures for 2011 show that total exports from western Canada reached $168.3 billion – an increase of 18.2% over the previous year. Thanks to high commodity prices, the region enjoyed strong export growth in a number of resource industries, but nowhere more so than in energy. Energy exports from the West, led by crude oil and coal, grew by 20.4% to reach $88.7 billion last year, the second highest level on record (energy exports hit $102.3 billion in 2008).

The increase in energy trade last year is further evidence of a long-term shift in the overall makeup of western Canada's exports. The region's exports have always been skewed heavily toward resource-based goods, especially oil and gas. However, surging volumes and higher prices have pushed the value of many energy products significantly higher, leaving other traditional resource exports like lumber, pulp, wheat, canola and various minerals in the dust.

In 2011, western Canadian energy exports were up 639% over 1990 levels, compared to an increase of 171% for non-energy products. While it is tempting (and correct) to assume that increasing oil sands exports from Alberta are driving this growth, the same trend is evident in all four western provinces. In particular, energy exports from Saskatchewan in 2011 were more than 11 times higher than in 1990.

As a result of this western-led growth, energy products have come to dominate Canada's overall export mix. Energy-related goods now account for four of the country's top seven export products. At $68.8 billion, crude oil (90% of which came from Alberta and Saskatchewan) was far and away Canada's largest export last year. Refined petroleum, mostly from New Brunswick, was the country's third largest export product. Natural gas (primarily from Alberta and Saskatchewan) and coal (mostly from BC) round out the country's leading energy-related export products.

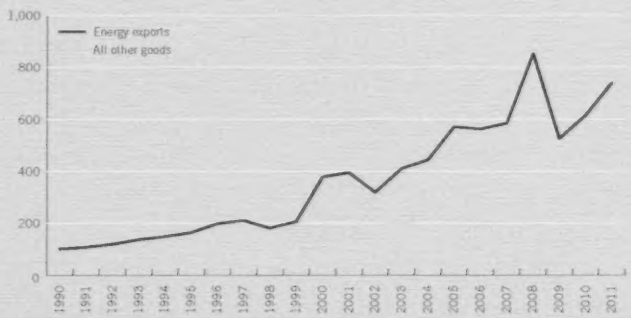
To be sure, the degree to which the western provinces rely on energy exports varies significantly within the region. To no one's surprise, Alberta is the most dependent on energy exports. Its $67.1 billion in energy sales – almost all of which go to the United States – accounted for 71.7% of the province's total exports in 2011. However, energy also accounts for a significant share of exports from Saskatchewan and BC – 35.5% and 30.2%, respectively. Only in Manitoba does energy represent a relative small share of exports (9.5%), although even there, that share has risen considerably over the past five years.

There is some debate as to whether or not growing energy exports from the West benefit this region at the expense of other parts of the country. Clearly, however, energy is playing a growing role in shaping Canada's future prosperity. The challenge will be to parlay energy production and trade into broad-based economic growth and prosperity for all of Canada.

**65.8%**

Increase in crude oil exports from Manitoba in 2011.

WESTERN CANADIAN EXPORTS OF ENERGY & NON-ENERGY GOODS (1990=100)




*Source: Canada West Foundation calculations using Statistics Canada data*

### DID YOU KNOW?

Led by crude oil, potash, wheat and canola, Saskatchewan was western Canada's fastest-growing exporter in 2011, posting a 24.5% increase. Nationally, Saskatchewan was second only to Newfoundland and Labrador.

In 2011, BC became the first province to export more to Asia than to the United States. Led by strong growth in trade with China and South Korea, BC exports to Asian markets totaled $14.3 billion in 2011 compared to $14.0 billion in exports to the US.

The West accounts for 100% of Canada's coal exports, 91.6% of crude oil exports and 95.4% of natural gas exports. By contrast, the rest of Canada accounts for 90.4% of the country's refined petroleum exports and 68.6% of its electricity exports.

## BEHIND THE NUMBERS

### Booming energy exports to the United States are masking evidence of export market diversification across western Canada.

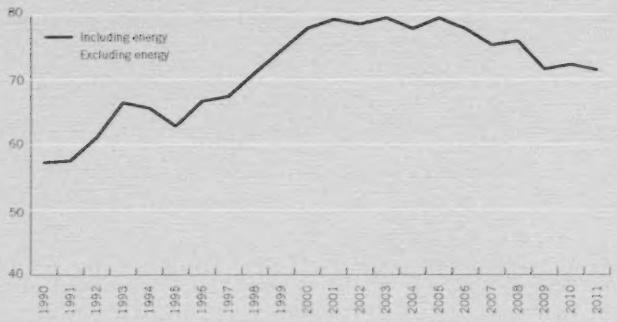
At first glance, BC and Manitoba have been steadily decreasing their reliance on the US as an export market over the past decade, while Alberta and Saskatchewan have not. However, a major reason behind this apparent lack of market diversification in Alberta and Saskatchewan is that crude oil and natural gas make up a significant share of exports from those provinces and that Canada is effectively a captive supplier of those products to the United States; the transportation infrastructure does not exist to send meaningful quantities of oil and gas anywhere else.

Removing energy products from the equation shows that Alberta and Saskatchewan have made considerable progress in finding new markets for their goods. In particular, Saskatchewan sold just 41.0% of its non-energy goods into the US market in 2011, the lowest share of any province in western Canada, including BC.

**81.7%**

of Alberta's exports to the US in 2011 were energy products.

WESTERN CANADIAN EXPORTS TO THE UNITED STATES (AS A % OF TOTAL EXPORTS)




*Source: Canada West Foundation calculations using Statistics Canada data*

EXPORTS TO THE UNITED STATES (AS A % OF TOTAL EXPORTS)

| | *Including Energy* | | *Excluding Energy* | |
|---|---|---|---|---|
| | 2001 | 2011 | 2001 | 2011 |
| British Columbia | 69.9 | 42.1 | 67.6 | 47.0 |
| Alberta | 88.9 | 86.3 | 70.6 | 55.8 |
| Saskatchewan | 58.6 | 61.9 | 46.0 | 41.0 |
| Manitoba | 78.5 | 60.8 | 75.2 | 56.6 |
| West | 79.2 | 71.4 | 66.5 | 49.8 |

*Source: Canada West Foundation calculations using Statistics Canada data*

## Energy Focus: Alberta

### Natural Gas

Continued supply growth in the United States, combined with reduced consumption demand from a relatively mild winter, has contributed to a weak economic environment for Alberta natural gas producers. Natural gas spot prices in early 2012 fell to their lowest point in a decade.

As a net gas producer and exporter, low prices are, on the whole, a negative for Alberta. Low prices reduce the value of gas output and exports from Alberta, making it difficult for producers to break even on their day-to-day operations. Moreover, low prices have a significant impact on the value of natural gas royalties collected by the province.

On the positive side, cheap natural gas is a boon for the oil sands industry which uses gas to extract and process the bitumen, as well as to fuel oil sands upgraders. Lower gas prices also reduce the cost of gas-fired electricity generation and benefit consumers by lowering the cost of home heating and other energy services.

Natural Gas Pipeline

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OPINION

BY MICHAEL HOLDEN, SENIOR ECONOMIST

# Time to End Pointless Bickering & Move Forward Together

Simmering tensions between the ascendant West and the struggling provinces in central Canada boiled over recently with a very public spat between Alberta Premier Alison Redford and Ontario Premier Dalton McGuinty. The disagreement began when Premier McGuinty suggested that, by driving up the Canadian dollar, oil production and exports from Alberta was to blame for Ontario's manufacturing woes.

That statement, which was later retracted, touched off a firestorm of commentary that, unfortunately, succeeded in doing little more than pitting one region against another by uselessly resurrecting historical grievances while also creating new ones. It also missed completely the larger point about how Canada should adapt to its current economic reality as an energy-driven economy.

To begin, there should be no doubt in anyone's mind that at least part of what Premier McGuinty says is true. Booming oil production and exports from Alberta is undoubtedly a major factor behind the rise in the Canadian dollar since 2003. And a stronger currency does drive up the costs of Canadian exports in the US market. But there are clearly other issues at play as well. For one, US demand for goods has been generally weak, regardless of where they are produced. Second, the Canadian dollar has not risen at all against several other major currencies, notably the yen and the euro. Finally, no reasonable amount of currency deflation would erase the competitiveness gap in manufacturing between Canada and low-wage countries in Asia.

On top of that, the loss in manufacturing employment is clearly a North America-wide phenomenon. Since 2003, the number of manufacturing jobs in Ontario has fallen by 27.8%. But in the US, where a strengthening currency has not been an issue at all, manufacturing employment fell by 19.1% over that same period.

Some commentators have been quick to point out that Ontario is hardly the only province whose exports are affected by a higher dollar. While this is technically true, it is also a tad disingenuous. Crude oil and other resources are priced in US dollars on international markets. As a result, the Canadian dollar acts as a bit of a buffer against price swings for many resource industries. Higher prices drive up the value of a barrel of oil for Alberta producers, but that gain is partially offset by a stronger dollar. The inverse is also true.

The main point, however, is that unless oil prices fall dramatically or oil sands development is shut down, a higher dollar is here to stay. There's as much to be gained from complaining about the exchange rate as there is from complaining about the weather.

Even so, the decline in manufacturing and the general economic and fiscal weakness in Ontario should concern all Canadians, including us here in the West. A lot of ink has been spilled about how Canada's economy and demographics are tilting westward, but the fact remains that Ontario still dominates. It accounts for 38.8% of the national population and just under two fifths of economic output and federal government revenue. No matter how wealthy they become, the western provinces are not a substitute for that contribution to the federation.

Rather than pointing fingers or rehashing irrelevant arguments about Canadian economic history, we need to concentrate on what actually matters: figuring out the best way forward for the country as a whole. Implicit in that statement is recognizing the importance of the energy sector to the national economy and accepting that the Canadian dollar will likely remain strong.

To that end, one good thing has already come out of the Alberta-Ontario tiff. Previously indifferent, Ontario has declared its support for a Canadian national energy strategy – a cause championed by Premier Redford. It is initiatives like these that will pave the way forward, not picking at old scars or looking to create new ones.

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